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IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Petitioner,

v.

INVESTMENT COMPANY INSTITUTE,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF OF *AMICUS CURIAE* SECURITIES INDUSTRY ASSOCIATION IN SUPPORT OF RESPONDENT

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BRIEF OF *AMICUS CURIAE* SECURITIES INDUSTRY ASSOCIATION IN SUPPORT OF RESPONDENT

The Securities Industry Association, with the consent of the parties, submits this brief, *amicus curiae,* in support of affirmance of the decision of the court of appeals below.

INTEREST OF THE *AMICUS CURIAE*

The Securities Industry Association ("SIA") is a national trade association representing approximately 500 organizations responsible for over 90 percent of the securities brokerage and investment banking business of the nation. Its membership is a cross-section of the diverse facets of the securities business and encompasses members of the national securities exchanges, as well as firms which are not members of such exchanges. The business of its members includes retail and institutional brokerage, over-the-counter market-making, underwriting and other invest-

ment banking activities. Many SIA members sponsor open- and closed-end investment companies, which permit the investing public to pool investment capital and obtain the advantages of a broader portfolio of investments than otherwise would be available to most individual investors.

The SIA and its members have a clear interest in whether this Court determines to sanction the continuing efforts of the banking industry to expand into the securities business. Such expansion, at the securities industry's expense, would not produce healthy competition because it would be based on inherent advantages, enumerated below, which make any competition between bank holding companies and members of the securities industry unequal and unfair. Moreover, if bank holding companies are to engage in the securities business, as the ruling of the Board of Governors of the Federal Reserve System ("Board") would permit and encourage, the result will be their domination of the capital markets and resultant distortion of our economy's capital-raising mechanism.

SUMMARY OF ARGUMENT

I

Investment Company Institute v. *Camp* held that Sections 16 and 21 of the Glass-Steagall Act prohibit a commercial bank from operating an investment fund which, in that case, was comparable to an open-end investment company. All of the investment companies operated by banks and bank affiliates during the period which preceded enactment of the Glass-Steagall Act, however, were of the closed-end variety. Thus, there is no plausible reason why Congress would have intended to limit the reach of the Act to open-end companies. The distinction drawn by the Board between the operation of open- and closed-end investment companies is not meaningful, either in terms of the hazards Congress sought in the Glass-Steagall Act to eliminate or the language of Sections 16 and 21. Similarly, there is no rational basis for the Board's contention that Congress

wished to permit banks to do indirectly, through affiliates, what they could not do directly. Thus Sections 16 and 21, as interpreted in *Camp,* must be read to prohibit banks and bank affiliates from operating closed- as well as open-end investment companies.

II

The regulation at issue was promulgated under Section 4(c)(8) of the Bank Holding Company Act, and its legality therefore must be measured by whether the activity it sanctions is "so closely related to banking . . . as to be a proper incident thereto." Although banks traditionally have managed common trust funds, there is a fundamental distinction between the sale of fiduciary services and the sale of investments. Operating investment companies is not a traditional bank activity. The Board itself has recognized that activities unlawful for banks may not be "closely related" or a "proper incident" to banking, and, as we will show, operation of a closed-end fund by a bank itself is unlawful under the Glass-Steagall Act. The legislative history of the 1970 amendments to the Bank Holding Company Act, which focused specifically on the "closely related" standard, confirm that that Act was not intended in any way to permit bank holding companies to engage in securities activities prohibited to banks.

III

The Board's reliance upon Section 20 of the Glass-Steagall Act is misplaced. *Camp* makes clear that, with respect to the operation of investment companies, Congress did not wish to permit banks to do indirectly, though affiliates, what they could not do directly. Since Congress intended to prohibit banks from operating closed- as well as open-end investment companies, Section 20 of the Glass-Steagall Act logically must be read to prohibit bank affiliates from operating closed- as well as open-end investment companies. Alternatively, it is a reasonable interpretation of that Section that it does not apply at all to bank holding company affiliates, the scope of whose non-banking activi-

ties is regulated by the Bank Holding Company Act. This interpretation is based on the premise that when Congress broadened the definition of "affiliate" in the Glass-Steagall Act in 1966 to include bank holding companies, it did so only for purposes of the Federal Reserve Act and not for purposes of the Glass-Steagall Act. Even if Section 20 does apply to bank holding companies, however, it is not an authorizing provision but a prohibitory one. Thus, an activity it fails to prohibit does not *ipso facto* meet the Section 4(c)(8) standard; it must satisfy that test independently, and operation of a closed-end fund cannot do so.

IV

The Court need not pay deference to the Board's interpretation of the applicable statutes in this case. Where, as here, the question before the Court is purely one of law or statutory construction, the expertise of the agency is not a ground for according it deference. The principle of judicial deference cannot override a court's general duty to interpret and apply the law as the court perceives it. In this area in particular, the Board's claim to deference is diminished by the frequency with which courts have found it necessary to circumscribe permissive rulings by federal bank regulators allowing bank expansion into non-banking activities. Moreover, the implications of the Board's ruling are so sweeping that they should be effected only by an unambiguous legislative mandate.

ARGUMENT

I. Sections 16 and 21 of the Glass-Steagall Act Prohibit the Operation by Banks of Closed-End Investment Companies

In *Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971), this Court held that Sections 16 and 21 of the Glass-Steagall Act[1] 12 U.S.C. §§ 24 Seventh and 378 pro-

[1] The Banking Act of 1933, Pub. L. No. 66, 48 Stat. 162, contains a number of provisions collectively known as the Glass-Steagall Act, which are presently codified at various places in Title 12 of the United States Code.

hibit banks from operating open-end investment companies. In that decision, the Court in no way limited the import of its holding to the operation of open- rather than closed-end companies. On the contrary, the Court framed the issue before it as whether the Comptroller of the Currency could "authorize a national bank to offer its customers the opportunity to invest in a *stock fund created and maintained by the bank.*" 401 U.S. at 621 (emphasis supplied). As shown below, there is no meaningful distinction between the operation of open- and closed-end investment companies in terms of the hazards Congress sought in the Glass-Steagall Act to eliminate. Moreover, the language of Sections 16 and 21, as interpreted in *Camp,* is as equally applicable to bank operation of a closed-end as it is an open-end investment company.

A. There is no meaningful distinction between the operation of open- and closed-end investment companies in terms of the hazards Congress sought to eliminate.

This Court determined in *Camp* that Sections 16 and 21 of the Glass-Steagall Act do not permit the Comptroller to "authorize a national bank to offer its customers the opportunity to invest in a stock fund created or maintained by the bank." *See* 401 U.S. at 621, 639. In *Camp* the Comptroller had argued that these Sections were intended to prohibit only the abuses which had occurred when banks or their security affiliates had invested bank assets in speculative securities or had engaged in underwriting original issues "for the traditional and direct form of distribution profit." *National Association of Securities Dealers, Inc.* v. *Securities and Exchange Commission,* 420 F.2d 83, 89-90 (D.C. Cir. 1969), *rev'd in part and vacated in part,* 401 U.S. 617 (1971). In rejecting that limited view of the intended reach of the Glass-Steagall Act, this Court pointed out that Congress "had in mind and repeatedly focused on the more subtle hazards" which arise when a commercial bank or its affiliate sponsors and controls an investment company which

obtains money from the general public to speculate in securities. 401 U.S. at 630.[2]

As shown in *Camp*, one of the specific concerns of Congress was the hazards to the soundness of the banking system which arise when bank security affiliates obtain funds from the general public, not for fiduciary purposes, but rather for the operation of an investment trust:

> The Glass-Steagall Act was the product of hearings conducted pursuant to Senate Resolution 71 which included among the topics to be investigated the impact on the banking system of the formation of investment and security trusts. The subcommittee found that one of the activities in which bank security affiliates engaged was that of an investment trust: "buying and selling securities acquired purely for investment or speculative purposes." Since Congress generally intended to divorce commercial banking from the kinds of activities in which bank security affiliates engaged, there is reason to believe that Congress explicitly intended to prohibit a national bank from operating an investment trust.

401 U.S. at 635 (footnotes omitted).

This Court observed in *Camp* that the operator of an investment fund "would necessarily put its reputation and facilities squarely behind that fund and the investment

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[2] Among the principal "more subtle" hazards identified by this Court in *Camp* were (A) impairment of public confidence in the bank if the securities affiliate fares badly since the bank and the affiliate become closely associated in the public mind; (B) pressure on the bank to make its credit facilities and possibly even unsound loans more readily available to companies in whose securities the affiliate has invested or otherwise becomes involved; (C) the possible risk that bank depositors would suffer losses on the investments they purchased in reliance on the relationship between the bank and its securities affiliate; (D) the danger that the bank would be tempted to make customer loans more liberally for purposes of facilitating the purchase of its affiliates' securities; and (E) conflict between the promotional interest of the investment banker and the obligation of the commercial banker to render disinterested investment advice. 401 U.S. at 630-34.

opportunity that fund offered," and poor performance of the fund "could bring about a perhaps unjustified loss of public confidence" in the sponsoring bank. 401 U.S. at 637. Both open- and closed-end investment funds are formed for the purpose of " 'buying and selling securities acquired purely for investment or speculative purposes,' " *see* 401 U.S. at 635 (footnote omitted), and the fact that a closed-end fund does not stand ready to redeem and sell its shares at net asset value, and thus typically sells its stock to the public less frequently that an open-end fund, does not materially reduce the risks inherent in the fund's operation or the loss of public confidence that would attend its failure. As the Court stated in *Camp*:

> If the fund investment should turn out badly, there would be a danger that the bank would lose the good will of those customers who had invested in the fund. It might be unlikely that disenchantment would go so far as to threaten the solvency of the bank. But because banks are dependent on the confidence of their customers, the risk would not be unreal.

401 U.S. at 638.

The Federal Reserve Board has sought to obviate this danger through its regulation prohibiting closed-end investment companies from using names similar to those of the sponsoring bank, 12 C.F.R. § 225.125(f) (1980), but it does not otherwise bar association of the sponsor's name with the fund. It therefore can be expected that banks will make every effort to ensure public awareness of the identity of the sponsoring bank. This was the experience in the case of the 1979 creation of the Chancellor High Yield Fund, Inc., where Citibank, N.A. acted as investment adviser to the fund. It was abundantly clear from the fund's initial press release and other promotional materials that the parties fully intended to make extensive use of Citibank's banking prestige and name in marketing the fund to the public. *See* Petition of Investment Company Institute for the Institution of Cease and Desist Proceedings Against Citibank, N.A., Before The Comptroller of the Currency (filed August 14, 1979).

Another potential hazard is the temptation for a bank imprudently to extend credit to those companies in which the fund has invested to prevent a failure or decrease in the value of the investment fund.[3] *Hearings Pursuant to S. Res. 71 Before a Subcommittee of the Senate Committee on Banking and Currency,* 71st Cong., 3d Sess. 1064 (1931). *See also* 75 Cong. Rec. 9912 (1932) (remarks of Sen. Bulkley). The bank's function as a disinterested and impartial allocator of credit is impaired by virtue of its association with the fund. In other words, "[t]he bank's stake in the investment fund might distort its credit decisions or lead to unsound loans to the companies in which the fund had invested." 401 U.S. at 637. Once again it is difficult to see any way in which a bank's "stake" in its fund is at all diminished merely because the fund's shares are not redeemable.

An additional congressional concern was the potential for conflict "between the promotional interest of the investment banker and the obligation of the commercial banker to render disinterested investment advice." 401 U.S. at 633. This conflict arises simply because the bank, whose fee typically is based on the amount of assets under its management, has an economic interest in accumulating funds for the investment company. Although the regulations of the Federal Reserve Board seek to avoid this conflict by prohibiting bank holding companies from soliciting the bank's customers for shares in the investment company itself, 12 C.F.R. § 225.125(h) (1980), the bank may be tempted to abuse its fiduciary duty by investing funds it holds in trust in the same securities held in the investment company's portfolio. This allows the bank to support the investment company's asset value to the possible detriment

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[3] An excellent illustration of this temptation is the experience in the early 1970s with bank-sponsored real estate investment trusts ("REITs"). The poor performance or failure of many projects in which REITs invested prompted their bank sponsors to extend numerous unsound loans to prevent the total collapse of the REITs.

of those for whom it acts as trustee. Once again, this danger is as real when a bank operates a closed-end as an open-end company.

Finally, there is the possibility that "the bank might exploit its confidential relationship with its commercial and industrial creditors for the benefit of the fund." 401 U.S. at 637-38. Banks have the opportunity to tie the granting of credit to their securities services and otherwise to use their lending relationship to gain additional business. The tie-ins which may occur when banks are involved in the marketing of securities services derive from the ability of commercial banks to extend credit. It is not so difficult to perceive how a creditor of a bank might think it consistent with maintaining "good banking relations" to appear on the list of holders of shares in the bank's investment company. The danger of such implicit tie-ins was discussed by Richard W. McLaren, then Assistant Attorney General in charge of the Antitrust Division, in testimony before the Senate Banking and Currency Committee when it was considering the 1970 one-bank holding company legislation:

> [T]here are dangers which are more of a structural nature—adverse competitive effects that would tend to develop naturally without actual overt use of the economic power carried over from the banking sphere.
>
> I refer to a voluntary form of reciprocity or tie-in effect, where a potential borrower may independently decide that, just because he might possibly be under watch, it is in his best interest to patronize bank-affiliated enterprises in the hope of improving his chances of obtaining credit from the bank on favorable terms, or indeed at all.

Hearings on S. 1052, S. 1211, S. 1664, S. 3823, and H.R. 6778 Before the Senate Committee on Banking and Currency, 91st Cong., 2d Sess. 239-40 (1970). *See also Hearings on H.R. 6778 Before the House Committee on Banking and Currency,* 91st Cong., 1st Sess. 91-92 (1969). Again, the likelihood of this situation arising is not at all dependent on whether or not the shares of the investment fund are redeemable.

There is no conceivable reason why Congress would have intended to limit the reach of the Glass-Steagall Act to the operation of an open- but not a closed-end investment company. During the period which led to the banking crisis that precipitated passage of the Glass-Steagall Act, substantially all of the investment companies in operation were of the closed-end rather than the open-end variety. *See Securities and Exchange Commission Report on Investment Trusts and Investment Companies* (Part 2), H.R. Doc. No. 70, 76th Cong., 1st Sess. 124 (Table 25) (1939). In 1929 not one open-end investment company was sponsored by a commercial bank or bank affiliate. Every investment company sponsored by a commercial bank or its security affiliate, including those whose abuses filled the pages of the SEC study, was closed-end. *Id.* To suggest, as does the Board, that Congress intended to prohibit banks or bank affiliates from sponsoring and controlling only open-end investment companies in effect says that Congress diagnosed the banking industry as having an abscessed tooth but then went ahead and pulled only the tooth next to it.

B. As interpreted by the Court in *Camp*, the terms of the Glass-Steagall Act prohibit banks from operating both closed- and open-end investment companies.

Section 16 of the Glass-Steagall Act provides:[4]

> The business of dealing in securities and stock by [any national or state member bank in the Federal Reserve System] shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the [member bank] shall not underwrite any issue of securities or stock. . . .

By its terms, the section strictly limits a bank's ability to deal in securities. If it does so, it may purchase and sell securities "solely upon the order, and for the account of,

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[4] The provisions of Section 16 are also made applicable to state member banks by Section 5(c) Fifth of the Glass-Steagall Act, 12 U.S.C. § 335.

customers." This limitation requires that the transaction be initiated by the customer. Even assuming *arguendo* that an investment fund created by a bank can be a "customer"—a definition plainly at odds with the import of the statute—virtually all transactions effected by a bank for a fund it operates would be initiated by the bank, not the "customer." [5] Thus, a bank's operation of any investment fund, whether open- or closed-end, would transgress the limits of Section 16.

Section 21 of Glass-Steagall provides:

> [I]t shall be unlawful . . . [f]or any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing . . . stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits. . . .

Section 21 thus forces every financial institution to make a choice. It may either engage in commercial banking or it may engage in the securities business; it may not do both.

The Court summed it up in *Camp* as follows:

> One would suppose that the business of a mutual fund consists of buying stock "for its own account" and of "issuing" and "selling" "stock" or "other securities" evidencing an undivided and redeemable interest in the assets of the fund. On their face, §§ 16 and 21 of the Glass-Steagall Act appear clearly to prohibit this activity by national banks.

401 U.S. at 625 (footnotes omitted). Although the Court made specific reference to a mutual fund, a closed-end fund engages in identical activity, albeit with less frequency.

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[5] A bank necessarily initiates transactions in securities for funds in respect of which it acts as trustee. It does so, however, pursuant to the trust powers granted it under authority of Section 11 of the Federal Reserve Act, Pub. L. No. 43, 38 Stat. 261 (1913), as implemented by Regulation F of the Federal Reserve Board, 12 C.F.R. Part 206 (1980).

But for purposes of these provisions, and particularly Section 21, frequency is irrelevant since the prohibition is unqualified.

In sum, for purposes of the Glass-Steagall Act, the distinction drawn by the Board between open- and closed-end funds is immaterial; the Act must be read to prohibit both. Any other reading of those provisions, or of the Court's decision in *Camp*, would constitute a wholly unwarranted exaltation of form over substance.

II. Section 4(c)(8) of the Bank Holding Company Act Does Not Permit Bank Holding Companies To Operate Closed-end Investment Companies

The regulation of the Board permitting operation by bank holding companies of closed-end investment funds was promulgated under Section 4(c)(8) of the Bank Holding Company Act of 1956, 12 U.S.C. § 1843(c)(8).[6] As the Board points out, Pet. Br. 19, an analysis of the requirements of any statute "must begin with the language of the statute itself." *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 568 (1979). *Accord, Transamerica Mortgage Advisers, Inc.* v. *Lewis*, —— U.S. ——, 100 S. Ct. 242 (1979); *Cannon* v. *University of Chicago*, 441 U.S. 677 (1979); *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462 (1977); *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977). But the Board looks to the wrong statute. An analysis of the prohibitions of Section 4(c)(8) of the Bank Holding Company Act must start not with Section 20 of the Glass-Steagall Act but with Section 4(c)(8) itself.

Section 4(c)(8) provides an exception to the general prohibitory language of Section 4(a) of the Bank Holding Company Act[7] "to permit the retention by a bank

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[6] The Bank Holding Company Act, Pub. L. No. 511, 70 Stat. 133 (1956), is codified at 12 U.S.C. §§ 1841 *et seq.*

[7] Section 4(a)(2) of the Act, 12 U.S.C. § 1843(a)(2), provides that:

> [N]o bank holding company shall . . . engage in any activities other than (A) those of banking or of managing or controlling

holding company of activities found to be closely related to *banking.*" S.Rep. No. 1095, 84th Cong., 1st Sess. 13 (1955) (emphasis supplied). It does not permit bank holding companies to engage in nonbanking activities—whether securities-related or not—if they merely refrain from doing so "principally." Moreover, the legislative history of this provision, *see infra,* pp. 17-21, leaves no doubt that Congress intended the proper incidents of banking to be defined in part by the prohibitions contained in the Glass-Steagall Act with respect to the activities of banks themselves.

As demonstrated in Part I, the operation by banks of closed-end investment companies is prohibited by Sections 16 and 21 of the Glass-Steagall Act. It is illogical to contend, as does the Board, that Congress intended to permit banks to engage indirectly, through the "back door" of their holding companies, in activities foreclosed to them directly: activity prohibited to banks simply cannot be "closely related" or a "proper incident" to banking. Thus the Board was without authority to conclude that the activity at issue is permissible for bank holding companies.

A. Under Section 4(c)(8), the operation of a closed-end investment company is not an activity "so closely related to banking . . . as to be a proper incident thereto."

The Board asserts that the operation of a closed-end investment company is "closely related" to banking because "banks generally engage in that activity or . . . in activities that are similar." Pet. Br. 54. In an attempt to prove that the operation of closed-end investment companies meets

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banks . . . and (B) those permitted under paragraph (8) of subsection (c). . . .

Section 4(c)(8), 12 U.S.C. § 1843(c)(8), provides an exception for:

> shares of any company the activities of which the Board . . . has determined . . . to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

this test, the Board points to the "conventional fiduciary services" traditionally engaged in by bank trust departments in organizing and managing "large collective investment funds such as common trust funds and pooled employee benefit funds." Pet. Br. 55. It is true that these are traditional and proper activities for banks acting in their fiduciary capacity on behalf of customers. But from this, the Board leaps to the conclusion that "it is evident that managing a closed-end investment company is 'closely related' to such traditional services." *Id.* In so doing, the Board ignores this Court's teaching in *Camp* and overlooks the fundamental distinction between the sale of fiduciary services and the sale of investments.

In *Camp,* this Court detailed the hazards that arise when a commercial bank goes beyond the business of acting as a fiduciary or managing agent and engages in the securities investment business. *See* 401 U.S. at 630. The Court emphasized that:

> These are all hazards that are not present when a bank undertakes to purchase stock for the account of its individual customers or to commingle assets which it has received for a true fiduciary purpose rather than for investment. These activities, unlike the operation of an investment fund, do not give rise to a promotional or salesman's stake in a particular investment; they do not involve an enterprise in direct competition with aggressively promoted funds offered by other investment companies; they do not entail a threat to public confidence in the bank itself; and they do not impair the bank's ability to give disinterested service as a fiduciary or managing agent. In short, *there is a plain difference between the sale of fiduciary services and the sale of investments.*

401 U.S. at 638 (emphasis added).

The Board itself has long recognized this "plain difference." As the Court pointed out in *Camp,* 401 U.S. at 621:

> The Board of Governors of the Federal Reserve System, which until 1962 had regulatory jurisdiction over

> all the trust activities of national banks, allowed the collective investment of trust assets only for "the investment of funds held for true fiduciary purposes." The applicable regulation, Regulation F, specified that "the operation of such Common Trust Funds as investment trusts for other than strictly fiduciary purposes is hereby prohibited." The Board consistently ruled that it was improper for a bank to use "a Common Trust Fund as an investment trust attracting money seeking investment alone and to embark upon what would be in effect the sale of participations in a Common Trust Fund to the public as investments." 26 Fed Reserve Bull. 393 (1940); *see also* 42 Fed Reserve Bull. 228 (1956); 41 Fed Reserve Bull. 142 (1955).

In asserting that the operation of closed-end investment companies is "closely related" to banking, then, the Board ignores not only this Court's crucial distinction in *Camp* between fiduciary and investment activity, but the policy of the Federal Reserve Board itself in its regulation of banks from 1913 to 1962.

The Board cites a Securities and Exchange Commission report of 1939 as indicating "that managing a closed-end investment company is 'closely related' to such traditional services" provided by banks. Pet. Br. 55. However, as the SEC report makes clear, with no ambiguity whatsoever, its study involved only the

> ". . . commingling of trust funds . . . into a common pool for more convenient and secure investment, *in which commingled fund there may be no other participants* . . ."[8]

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[8] *Securities and Exchange Commission Report on Investment Trusts and Investment Companies* (Supplemental Report on Commingled or Common Trust Funds Administered by Banks and Trust Companies), H.R. Doc. No. 476, 76th Cong., 2nd Sess. 3 n. 3 (1939), *quoting* McWhinney, *Results from Questionnaire on Commingling of Trust Funds*, 52 Trust Company Magazine 334 (1931) (emphasis supplied).

Thus, the report does not at all define the traditional role of a bank as including the management of a closed-end investment company. Rather, the scope of the report is explicitly limited to bank operation of common trust funds, and is not in any way concerned with the activity at issue here.

The Board also cites another report of the Securities and Exchange Commission,[9] which indicates that banks and trust companies sponsored twelve closed-end investment companies both before and after the passage of the Glass-Steagall Act, as supporting its contention that banks have traditionally engaged in the activities now sought to be permitted. Pet. Br. 55. But such an interpretation is unjustified. First, since the category explicitly includes trust companies, it is not clear from this information how many of these twelve investment companies were operated by commercial banks. SEC Report, *supra* note 9, at 124. Second, the report indicates that a bank may have been assumed to be the fund's "sponsor" simply because of difficulties in identifying the true sponsor or organizer. *Id.* at 56. The report, then, is highly ambiguous and vague in its use of terminology. Even if this were not so, the continued existence of bank-operated closed-end investment companies in 1935 is ultimately irrelevant to the determination of Congressional intent in 1933.

The Board itself has recognized that activities which are unlawful if engaged in by banks may not be seen as "so closely related to banking . . . as to be a proper incident thereto." *See, e.g., Montana Shares, Inc.*, 47 Fed. Res. Bull. 767, 772 (1961). *Cf., St. Joseph Agency, Inc.*, 47 Fed. Res. Bull. 290, 293 (1961). As has already been demonstrated, Sections 16 and 21 of the Glass-Steagall Act make it unlawful for banks to engage in the operation not only of

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[9] *Securities and Exchange Commission Report on Investment Trusts and Investment Companies* (Part 2), H.R. Doc. No. 70, 76th Cong., 1st Sess. 57-58, 124 (Table 25) (1939) [hereinafter cited as "*SEC Report*"].

open-end investment companies but closed-end companies as well. Thus, the plain meaning of Section 4(c)(8) compels the conclusion that this activity cannot be a "proper incident" to banking.

B. The legislative history of the Bank Holding Company Act also shows that Congress intended to prohibit the activity in question to bank holding companies.

In 1970, Congress amended the Bank Holding Company Act to bring one-bank holding companies under its terms. At the same time, all the other provisions of the Act were subjected to "almost two years of detailed, thorough, and protracted consideration," H.R. Conf. Rep. No. 91-1747, 91st Cong., 2d Sess. 12 (1970). The House conferees noted that:

> Aside from the question of applying the Bank Holding Company Act of 1956 to one-bank holding companies . . . the most important and controversial issue was over the question of whether to retain or substantially change the 1956 definition as to what the Federal Reserve Board could permit regulated bank holding companies to engage in outside their strictly banking activities.

Id. at 13.

In the course of Congress' detailed consideration of Section 4(c)(8), it heard from a number of witnesses who complained that the "closely related" standard too restrictively bound the Federal Reserve Board in its ability to permit holding companies to engage in new forms of enterprise. *See id.* at 20. In order to "allow the Federal Reserve Board greater flexibility in determining what nonbanking activities . . . are to be permitted bank holding companies," these witnesses advocated the substitution of the phrase "functionally related" for the Section 4(c)(8) language. S. Rep. No. 91-1084, 91st Cong., 2d Sess. 12 (1970). This substitution was intended to "significantly broaden Section 4(c)(8) by the adoption of a new test." H.R. Conf. Rep. No. 91-1747, 91st Cong., 2d Sess. 19 (1970).

Both the Senate and the House passed amended versions of Section 4(c)(8) which contained this "functionally related" language, although the two Houses differed on other aspects of the Section. As a condition of replacing the "closely related" test with the government's "functionally related" language, the House bill would have expressly prohibited bank holding companies from engaging in:

> the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds, or other similar securities . . . *whether or not any such interests are redeemable* and whether or not the securities to which any such interests relate are a fund or account or are subject to discretionary sale or purchase. . . .

115 Cong. Rec. 33133 (1969) (emphasis supplied). This prohibition would have covered both open-end and closed-end investment companies but was eliminated in Conference Committee "apparently in return for a retention of the pre-1970 'closely related' language." *Alabama Association of Inurance Agents* v. *Board of Governors of the Federal Reserve System*, 533 F.2d 224, 238 (5th Cir. 1976), *modified on other grounds*, 558 F.2d 729 (1977), *cert. denied*, 435 U.S. 904 (1978). The government recognized, however, that even the liberal standard of the "functionally related" language would not have permitted bank holding companies to engage in this activity even in the absence of an express prohibition, because banks themselves had long been precluded from such activity:

> We could have lived with [the "functionally related"] language. Unfortunately, on the floor of the House, they went on to say that certain activities are not functionally related to banking and listed several areas —*one we would agree with to be excluded, the securities business.* This has been traditional for years—but listed some five or more other areas where banks are operating and have been operating for many, many years.

Hearings on S. 1052, S. 1211, S. 1664, S. 3823, and H.R. 6778 Before the Senate Committee on Banking and Cur-

rency, 91st Cong., 2d Sess. 18 (1970) (emphasis supplied) (statement of Dr. Charls Walker, Under Secretary of the Treasury).

The Conference Report on the 1970 Amendments is unequivocal as to the meaning of this retention of the original Section 4(c)(8) standard:

> . . . Congress intends that those activities which the Board and other witnesses claim would have been permitted under the "functionally related test", *are not authorized* by our decision to retain the "so closely related" test, which is considerably less expansive and liberal than the rejected "functionally related test." The significance of the Conferees' decision regarding the language finally adopted for section 4(c)(8) is enhanced by the fact that the Congress . . . has examined and reaffirmed its determination to keep bank holding companies in banking and in only those areas which are so closely related to banking as to be proper incident thereto.

H.R. Conf. Rep. No. 91-1747, 91st Cong. 2d Sess. 21-22 (1970) (emphasis supplied). Nevertheless, as the court of appeals noted in its decision, "[c]ourts have disagreed as to . . . [the] implications" of the retention by Congress in 1970 of the original "closely related" standard of Section 4(c)(8). *Investment Company Institute* v. *Board of Governors of the Federal Reserve System,* 606 F.2d 1004, 1019 (D.C. Cir. 1979).[10]

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[10] For example, in *Alabama Association of Insurance Agents* v. *Board of Governors of the Federal Reserve System,* 533 F.2d 224 (5th Cir. 1976), *modified on other grounds,* 558 F.2d 729 (1977), *cert. denied,* 435 U.S. 904 (1978), the Fifth Circuit found that "[a]ny liberalization of the standards" effected by other wording changes in section 4(c)(8) "was largely if not wholly offset by the Conference Committee's rejection of the 'functionally related standard' and the addition of the 'public benefits test.' " 533 F.2d at 239. The District of Columbia Circuit, on the other hand, has written that "it is plain that Congress intended to expand [the Board's] latitude in substantial degree." *National Courier Association* v. *Board of Governors of the Federal Reserve System,* 516 F.2d 1229, 1236 (D.C. Cir. 1975).

Whatever the precise implications of retaining the standard, however, it at least remains clear that activities prohibited to banks cannot be "closely related" or a "proper incident" to banking. Indeed, the Board itself told Congress that bank holding companies "should be regarded principally as a convenient alternative organizational arrangement for performing activities *that banks may perform themselves.*" *Hearings on H.R. 6778 Before the House Committee on Banking and Currency,* 91st Cong., 1st Sess. 208 (1969) (statement of J. L. Robertson, Vice-Chairman of the Federal Reserve Board) (emphasis supplied). Petitioner's present attempt to elevate the "convenient alternative organizational" form of a bank holding company over its obvious substance is precisely that against which the Board warned during its testimony in 1969:

> [W]hen Congress has clearly limited the powers of banks, they should not be permitted to circumvent such limitations . . . through affiliation in a holding company system. If the limitation is to be removed or modified, it should be done by congressional action. Before Congress does act to alter a limitation, it should decide whether the proposed activity is appropriate for banks to engage in directly. If so, the law should be changed in order that they may do so themselves, as well as through a subsidiary or through an affiliate in a holding company.

Id. at 207.

In any event, the implications of the language finally settled on by the Conference Committee, as that language applies to the regulation challenged in this case, was made explicit in the course of the debates on the floor of the Senate:

> Mr. WILLIAMS of New Jersey . . . I wonder whether there was any intention to imply that the very securities-related activities forbidden to banks directly may nevertheless be engaged in by bank-holding companies or their nonbanking affiliates.

> Mr. SPARKMAN. The answer to the Senator's question is that there clearly was not.

116 Cong. Rec. 42430 (1970).

III. The Board's Reliance Upon Section 20 of the Glass-Steagall Act Is Misplaced.

The Board in its Brief before this Court argues that Congress intended in Section 20 of the Glass-Steagall Act to permit bank holding company affiliates to operate closed-end investment companies, provided such companies are not "engaged principally" in selling securities. Pet. Br. 19-39. But the Board's reliance upon Section 20 of the Glass-Steagall Act is misplaced. *Camp* makes clear that with respect to the operation of investment companies, Congress did not wish to permit banks to do indirectly, through affiliates, what they could not do directly. Since Congress intended to prohibit banks from operating closed- as well as open-end investment companies, Section 20 logically must be read to prohibit bank affiliates from operating closed- as well as open-end investment companies.

If the Board's reading of Section 20 were correct, a bank readily could avoid the proscriptions of Section 21 by the simple expedient of establishing an affiliate to operate its closed-end investment fund. But *Camp* makes clear that Congress intended no such loophole:

> The legislative history of the Glass-Steagall Act shows that Congress also had in mind and repeatedly focused on the more subtle hazards that arise when a commercial bank goes beyond the business of acting as fiduciary or managing agent and enters the investment banking business *either directly or by establishing an affiliate to hold and sell particular investments.*

401 U.S. at 630 (emphasis supplied).

It is a reasonable interpretation of Section 20, however, that it does not apply at all to bank holding company af-

filiates, the scope of whose nonbanking activities is regulated by the Bank Holding Company Act. The Glass-Steagall Act was passed by Congress in 1933 "to prohibit commercial banks . . . from going into the investment banking business," *Investment Company Institute* v. *Camp*, 401 U.S. 617, 629 (1971). Sections 16 and 21 of the Act imposed an absolute prohibition on banks' engaging in specified securities-related activities. Section 19 of the Act,[11] in pertinent part, applied specifically to holding company affiliates of banks and prohibited those companies from voting their shares in the banks they owned unless they agreed not to own, control, or have any interest in a "securities company."[12] Congressional dissatisfaction with the holding company provisions of the Glass-Steagall Act began, however, almost immediately after the Act's passage. Attempts to pass legislation adequately regulating bank holding companies were made first in 1938 and continued periodically for almost 20 years. *See* S. Rep. No. 1095, 84th Cong., 1st Sess. 3-4 (1955).

Thus, since "existing provisions of law . . . [had] proved entirely inadequate to deal with the special problems presented by bank holding companies," Congress in 1956 enacted wholly new legislation designed to deal comprehensively with bank holding companies. S. Rep. No. 1095, 84th Cong., 1st Sess. 2 (1955) (*quoting* testimony of William McChesney Martin, Chairman of the Federal Reserve

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[11] 48 Stat. 186, 12 U.S.C. § 61 (1958 ed.). Section 19 was amended in 1966 to remove all references to holding company affiliates. Pub. L. No. 89-485, § 13(c), 80 Stat. 242 (1966).

[12] Section 19(e) defined "securities company" as

> . . . any corporation, business trust, association, or other similar organization formed for the purpose of, or engaged principally in, the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail or through syndicate participation, of stocks, bonds, debentures, notes, or other securities of any sort. . . .

48 Stat. 188.

Board). The more direct and streamlined provisions of this new legislation superseded as a practical matter the bank holding company provisions of Section 19 of the Glass-Steagall Act, which Congress had determined to be an "inadequate" legislative response to the problems of bank holding companies.

Congress' intention to replace the bank holding company provisions of Section 19 with the more direct provisions of the Bank Holding Company Act was made even clearer ten years later. In 1966, Section 19 was amended [13] to repeal its holding company provisions because their "effectiveness . . . is open to question and it is doubtful whether, in view of the enactment of the Bank Holding Company Act, they are now sufficiently useful to justify their retention," S. Rep. No. 1179, 89th Cong., 2d Sess. 12 (1966). The repeal of the "holding company affiliate" provisions of Section 19 obviated the need for a separate definition of that term in the Glass-Steagall Act, and Section 2(c) of that Act, 12 U.S.C. § 221a(c) (1958 ed.)—which defined "holding company affiliate"—was thus deleted.[14] At the same time, provisions of the Federal Reserve Act [15] were amended to delete the use of the term "holding company affiliate," and were instead made applicable merely to "affiliates." [16] To ensure that holding company affiliates remained covered by Sections 9 and 21 of the Federal Reserve Act, 12 U.S.C. §§ 321 *et seq.* and 481 *et seq.* (concerning reporting and examination requirements for state members and national banks), the definitional provisions of Section 2(b) of the Glass-Steagall Act were amended to include holding company affiliates under the general defini-

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[13] Pub. L. No. 89-485, § 13(c), 80 Stat. 242 (1966).

[14] Pub. L. No. 89-485, § 13(b), 80 Stat. 242 (1966).

[15] Pub. L. No. 43, 38 Stat. 251 (1913).

[16] Pub. L. No. 89-485, §§ 13(f), (h), 80 Stat. 243 (1966).

tion of "affiliates." [17] The Senate Report on the 1966 amendments thus states explicitly that the amendments to the definition of "affiliate" in the Glass-Steagall Act were simply "to make clear that [Sections 9 and 21 of the Federal Reserve Act] apply to holding company affiliates" of banks as well as to other bank affiliates. S. Rep. No. 1179, 89th Cong., 2d Sess. 13 (1966). The legislative history of these 1966 amendments, then, supports the contention that Congress intended to treat bank holding companies as "affiliates" solely for purposes of the Federal Reserve Act, and *not* for purposes of the Glass-Steagall Act.

While it can be argued that in amending the definitional section of the Glass-Steagall Act, Congress somehow brought bank holding companies within the terms of Section 20 of that Act, this contention would appear inconsistent with the clear expression of Congress' intent in 1966, noted above, merely to effect certain technical amendments. Moreover, it suggests that Congress, in making these technical amendments, intended to subject the securities activities of bank holding companies to Section 20 of the Glass-Steagall Act, which contained substantive provisions substantially equivalent to those it had just repealed in Section 19, without any indication that it intended such an effect. The Senate's 1966 Report indicates that Congress had no such motive:

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[17] Section 2(b) of the Glass-Steagall Act was amended to include in the definition of "affiliate" any corporation or similar entity—

> (4) Which owns or controls, directly or indirectly, either a majority of the shares of capital stock of a member bank or more than 50 per centum of the number of shares voted for the election of directors of a member bank at the preceding election, or controls in any manner the election of a majority of the directors of a member bank, or for the benefit of whose shareholders or members all or substantially all the capital stock of a member bank is held by trustees.

Pub. L. No. 89-485, § 13(a), 80 Stat. 242 (1966).

> [E]limination [of the holding company provisions of Section 19] would remove the confusion that results from the existence of two sets of laws that relate to the same general subject but are based on different definitions of what constitutes a holding company.[18]

S. Rep. No. 1179, 89th Cong., 2d Sess. 12 (1966).

The Board next argues that because, as bank "affiliates", bank holding companies would not be prohibited, under its interpretation of Section 20, to engage in the operation of closed-end investment companies, that activity necessarily is one "so closely related to banking" as to be permitted under the separate provisions of the Bank Holding Company Act. But the Board's analysis of Section 4(c)(8) of the Bank Holding Company Act is as flawed as its interpretation of Section 20 of the Glass-Steagall Act.

The Glass-Steagall Act is not an authorizing statute but a prohibitory one. It does not follow that merely because a particular activity may escape its proscriptions such activity is permissible under the Bank Holding Company Act. The activity also must be so "closely related" to banking as to be a "proper incident" thereto. As the preceding section has demonstrated, operation of a closed-end fund cannot meet this test. Moreover, nothing in the legislative history suggests that Congress' real intention in 1956 and again in 1966 and 1970 was to carve out of the general prohibitions of Section 4 of the Bank Holding Company Act an exception allowing bank holding companies to engage in any securities activity—no matter how remotely related to banking or how similar to the kind of activity clearly prohibited to banks themselves under the Glass-Steagall Act—as long as the holding company did not engage *principally*

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[18] Under the Glass-Steagall Act, a holding company affiliate was defined in 1966 as a company owning more than 50 percent of the stock of any member bank, whereas under the Bank Holding Company Act, a holding company was defined in 1966 as one owning 25 percent or more of each of two or more banks, whether or not they were members of the Federal Reserve System. *See* S. Rep. No. 1179, 89th Cong., 2d Sess. 12 (1966).

in the issuance, flotation, underwriting, sale or distribution of securities. To contend that this is what Congress meant is to disregard the central proscription of the Bank Holding Company Act and to frustrate the congressional intent which motivated its passage.

IV. The Board's Regulation Is Not Entitled To Judicial Deference

A. The concept of deference cannot override the Court's ultimate duty properly to interpret statutes.

In urging the Court to uphold the Board's action in this case, the Board predictably invokes the general principle of "deference" to the determinations of agencies charged with the duty of interpreting a particular statute in the first instance. Pet. Br. 37-38.

This Court's approach to the "deference" principle, however, has been carefully qualified by emphasis upon the limitations of that general principle. Only recently, this Court emphasized in *Mohasco Corp.* v. *Silver,* 48 U.S. L.W. 4851, 4855 (June 23, 1980) that "[a]s we have held on prior occasions, [an agency's] 'interpretation' of the statute cannot supersede the language chosen by Congress." Similarly, in *International Brotherhood of Teamsters* v. *Daniel,* 439 U.S. 551, 566 n. 20 (1979), the Court stated that deference to an interpretation by an administrative agency must be "constrained by our obligation to honor the clear meaning of a statute, *as revealed by its language, purpose, and history*" (emphasis supplied). To the same effect is the Court's statement in *Securities and Exchange Commission* v. *Sloan,* 436 U.S. 103, 118-19 (1978) (citing *Volkswagenwerk* v. *FMC,* 390 U.S. 261, 272 (1968)) that:

> [T]he courts are the final authorities on issues of statutory construction . . . and are not obliged to stand aside and rubber-stamp their affirmance of administrative decisions *that they deem inconsistent with a statutory mandate or that frustrate the congressional policy underlying a statute* (emphasis supplied) (citations omitted).

This is a case where whatever deference would normally be accorded to the Board is plainly preempted by the clear

import of the statutory provisions in question and the manifest congressional intent underlying them. The extent to which deference should be accorded here is further diminished by the frequency with which the courts have found it necessary in this area to overturn or modify determinations by federal banking authorities authorizing expanded activities by banks.[19]

The courts have also specifically overturned interpretations by the Board of the "closely related" standard to the extent that the Board's decisions were found to be inconsistent with the legislative intent under the Bank Holding Company Act. *E.g., National Courier Association* v. *Board of Governors of the Federal Reserve System,* 516 F.2d 1229, 1240-41 (D.C. Cir. 1975); *Alabama Association of Insurance Agents* v. *Board of Governors of the Federal Reserve System,* 533 F.2d 224, 241-44 (5th Cir. 1976), *modified on other grounds,* 558 F.2d 729 (5th Cir. 1977), *cert. denied,* 435 U.S. 904 (1978). Thus, the manifest tendency of the federal banking authorities to exceed the limits of the statute in authorizing expanded activities by banks (and bank holding companies) indicates that any "deference" to agency rulings in this area must be tempered by considerable skepticism.[20]

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[19] *Investment Company Institute* v. *Camp,* 401 U.S. 617 (1971); *First National Bank* v. *Dickinson,* 396 U.S. 122 (1969); *National Retailers Corp.* v. *Valley Bank,* 604 F.2d 32 (9th Cir. 1979); *Arnold Tours, Inc.* v. *Camp,* 472 F.2d 427 (1st Cir. 1972); *Saxon* v. *Georgia Association of Independent Insurance Agents, Inc.,* 399 F.2d 1010 (5th Cir. 1968); *Baker, Watts & Co.* v. *Saxon,* 261 F. Supp. 247 (D.D.C. 1966), *aff'd sub nom., Port of New York Authority* v. *Baker, Watts & Co.,* 392 F.2d 497 (D.C. Cir. 1968).

[20] The SIA itself has had direct experience with the interpretive flexibility of bank regulators. In 1977, the SIA petitioned the Board concerning private placements of securities by commercial banks. In a "Staff Study", the Board found that these placements did not constitute "dealing", "underwriting" or any other activity in violation of Section 16 or 21 of the Glass-Steagall Act. Later in 1977, the SIA petitioned the Board in connection with the sale of securities to the public by a subsidiary of Citicorp of notes issued by Citicorp. The Board found that Section 20 of the Glass-

B. The implications of the Board's regulation, especially its adverse impact on the concentration of economic power, are so sweeping they should be effected only by an unambiguous legislative mandate.

In the course of testifying last year on pending legislation to limit the scope of bank holding company activity, the Chairman of the Securities and Exchange Commission noted, *inter alia*, that the structure of the securities industry has been undergoing substantial change since the elimination in 1975 of fixed brokerage commissions and the effort to develop a national market system. He also observed that banks may achieve competitive advantages over securities firms because there are significant differences in the laws and regulations governing them from those governing securities firms. The Chairman concluded:

> The Commission shares the concerns addressed in H.R. 2747 and H.R. 2856 with respect to the proper role of banks in securities activities. . . . [T]he bills now before you raise important questions with respect to the health of our capital markets, and the continued validity of the traditional distinction between commercial and investment banking. We favor competition. Indeed, we are charged by our statutes to promote it. But these bills raise questions about the dangers of excessive concentration of economic power, about the financial service needs of the public and private sectors, about potential conflicts of interest and about unequal regulation. These are important, broad and complex issues which need to be addressed by the Congress.

Steagall Act was not violated because Citicorp and its subsidiary, viewed as a "single entity", were not engaged principally in an activity prohibited by Section 20. Again, in 1979, the SIA petitioned the Board on the issue of whether commercial banks could act as sellers of commercial paper for corporate issuers. The Board's general counsel issued an opinion to the effect that this activity was permissible, chiefly because commercial paper was not a "security" for purposes of the Glass-Steagall Act. The substance of this ruling is now the subject of another SIA petition, which has been pending before the Board for almost a year.

Hearings on H.R. 2255, H.R. 2747, H.R. 2856, H.R. 4004 Before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the House Committee on Banking, Finance and Urban Affairs, 96th Cong., 1st Sess. 13, 17-18 (1979).

Banks and bank holding companies not only are free from the costly regulation that burdens members of the securities industry, the sheer size of the money center banks in relation to the securities industry also suggests that the latter would be unable to compete successfully against the wealth of resources available to these banks and their affiliated holding companies.[21] For example, bank holding companies quickly became leading participants in the personal finance and mortgage banking fields after being permitted to engage in such activities.

The inability of the securities industry to compete against the money center banks would result in decreased competition in financial services. At the present time, commercial bankers and investment bankers generally compete to serve the capital needs of the same customers by offering different products. The commercial bankers offers a variety of commercial loan packages, funded by one or more banks, while the investment banker offers a variety of securities packages, funded by investors through public or private offerings. If commercial banks were allowed to offer both products, and came to dominate both financing alternatives, development of innovative financing vehicles would be stifled, and a few money center banks in effect would contral access to the capital markets by American industry. Such a result not only would be to the disadvantage of the customer seeking to satisfy his capital-raising needs in the most efficient and least costly manner, but also would dis-

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[21] As of March 31, 1980, the equity capital of all member firms of the New York Stock Exchange doing business with the public was $4.1 billion. As of the same date, the combined shareholders' equity of Citicorp and BankAmerica Corporation alone exceeded $7 billion.

tort the economy's delicate capital allocation process and lead to the realization of Judge McGowan's fears:

> [T]he Board's interpretive ruling fails to give due weight to a second evil that was thought to flow from the growth of one-bank holding companies: the centralization of economic power in the American economy. Congress was deeply concerned that the economy was becoming structured along the lines of the Japanese "Zaibatsu" system, in which economic power was concentrated in a few gigantic power centers. This concern for the structural integrity of the economy will be present even if there were fully adequate safeguards against abuse of the subsidiary bank's economic power. Yet, the Board's action in the present case, permitting bank holding companies or their affiliates to control the investment decisions for large pools of capital, would seem to portend the type of centralization of power that Congress feared in the 1970 Amendments.

Investment Company Institute v. *Board of Governors of the Federal Reserve System*, 606 F.2d 1004, 1023 (footnotes omitted).

CONCLUSION

Amicus curiae Securities Industry Association respectfully urges that for the foregoing reasons, and for the reasons set forth in Respondent's Brief, the decision of the court of appeals below should be affirmed.

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